

Internal Revenue Service, Treasury

§ 1.861-14T

Total apportioned expense\$100,000

Example 3: (i) Facts. The facts are the same as in *Example (2)* above, except that only employees of P and X participate in the training program.

(ii) *Analysis.* Because only the employees of P and X participate in the training program and they perform no services for Y, the ex-

pense relates only to gross income generated by P and X. Accordingly, the \$100,000 expense must be allocated and apportioned as if P and X were a single corporation. The apportionment of the \$100,000 expense is as follows:

Apportionment of \$100,000 expense to foreign source general limitation income:

$$\$100,000 \times \frac{\$200,000 + \$100,000}{\$400,000 + \$200,000} = \$50,000$$

Apportionment of \$100,000 expense to U.S. source gross income:

$$\$100,000 \times \frac{\$200,000 + \$100,000}{\$400,000 + \$200,000} = \$50,000$$

Example 4: (i) Facts. P owns all of the stock of X which owns all of the stock of Y. P and X are domestic corporations; Y is a foreign corporation. In 1987 P incurred \$10,000 of stewardship expenses relating to an audit of Y.

(ii) *Analysis.* The stewardship expenses incurred by P are not directly allocable to specific income producing activities or property of P. The expense is definitely related and allocable to dividends received or to be received by X. Accordingly, the expense of P is allocated and apportioned as if P and X were a single corporation. The expense is definitely related to dividends received or to be received by X from Y, a foreign corporation. Such dividends are foreign source general limitation income. Thus, the entire amount of the expense must be allocated to foreign source dividend income.

Example 5: (i) Facts. P owns all of the stock of X which owns all of the stock of Y. P, X and Y are all domestic corporations. In 1987, P incurred \$10,000 legal expense relating to the testimony of certain employees of P in connection with litigation to which Y is a party. This expense is not allocable to specific income of Y. In 1987, Y had \$100,000 foreign source general limitation income and \$300,000 U.S. source gross income.

(ii) *Analysis.* The legal expenses incurred by P are not definitely related solely to specific income producing activities or property of P. The expense is definitely related and allocable to the class of gross income which includes only gross income generated by Y. Accordingly, the expense of P is allocated and apportioned as if Y were the only member of the affiliated group, as follows:

Apportionment of legal expenses to foreign source general limitation income:

$$\$10,000 \times \frac{\$100,000}{\$400,000} \dots\dots \$2,500$$

Apportionment of legal expenses to U.S. source gross income:

$$\$10,000 \times \frac{\$300,000}{\$400,000} \dots\dots \$7,500$$

Example 6: (i) Facts. P owns all of the stock of R, which owns all of the stock of F. P and R are domestic corporations, and F is a foreign sales corporation under section 922 of the Code. R and F have entered into an agreement whereby F is paid a commission with respect to sales of product A. In 1987, P had gross receipts of \$1,000,000 from domestic sales of product A, and gross receipts of \$1,000,000 from foreign sales of product A. R had gross receipts of \$1,000,000 from domestic sales of product A, and \$1,000,000 from export sales of product A. R's cost of goods sold attributable to export sales is \$500,000. R has deductible expenses of \$100,000 directly related to its export sales, and F has such deductible expenses of \$100,000. During 1987, P incurred an expense of \$100,000 for marketing studies involving the worldwide market for product A.

(ii) *Analysis.* P and R are an affiliated group of corporations within the meaning of section 864(e)(5) and this section. The expense incurred by P for marketing studies regarding the worldwide market for product A is an expense that is not directly related solely to the activities of P, but also to the

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activities of R. This expense must be allocated and apportioned under the rules of paragraph (c)(1) of this section, as if P and R were a single corporation. The expense is allocable to the class of gross income that includes all gross income generated by sales of product A. Apportionment on the basis of gross receipts is reasonable under these facts. F, a foreign corporation, is not a member of the affiliated group. However, for purposes of determining F's commission on its sales, the combined gross income of F and R must be reduced by the portion of the marketing studies expense of P that is incurred

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in connection with export sales involving F under the rules of paragraph (f) of this section. The computation of the combined taxable income of R and F is as follows:

<i>Combined Taxable Income of R and F</i>	
R's gross receipts from export sales	\$1,000,000
R's cost of goods sold	\$500,000
Combined Gross Income	\$500,000
Less:	
R's other deductible expenses	\$100,000
F's other deductible expenses	100,000
Apportionment of P's expense:	

$$\$100,000 \times \frac{\$1,000,000}{\$200,000 + \$2,000,000} \dots\dots \$25,000$$

Total	\$225,000
Combined Taxable Income	\$275,000

(k) *Effective/applicability date.* The rules of this section apply for taxable years beginning after December 31, 1986.

[T.D. 8228, 53 FR 35501, Sept. 14, 1988, as amended by T.D. 8916, 65 FR 274, Jan. 3, 2001; T.D. 9143, 69 FR 44932, July 28, 2004; T.D. 9211, 70 FR 40663, July 14, 2005; T.D. 9456, 74 FR 38875, Aug. 4, 2009]

§ 1.861-15 Income from certain aircraft or vessels first leased on or before December 28, 1980.

(a) *General rule.* A taxpayer who owns an aircraft or vessel described in paragraph (b) of this section and who leases the aircraft or vessel to a United States person (other than a member of the same controlled group of corporations (as defined in section 1563) as the taxpayer) may elect under paragraph (f) of this section to treat all amounts includible in gross income with respect to the aircraft or vessel as income from sources within the United States for any taxable year ending after the commencement of the lease. This paragraph (a) applies only with respect to taxable years ending after August 15, 1971, and only with respect to leases entered into after that date of aircraft or vessels first leased by the taxpayer on or before December 28, 1980. An election once made applies to the taxable year for which made and to all subsequent taxable years unless it is revoked or terminated in accordance with paragraph (g) of this section. A taxpayer

need not be a United States person to be eligible to make the election under this section, unless otherwise required by a provision of law not contained in the Internal Revenue Code of 1954. In addition, the taxpayer need not be a bank or other financial institution to be eligible to make this election. The term "United States person" as used in this section has the meaning assigned to it by section 7701(a)(30).

(b) *Property to which the election applies*—(1) *Section 38 property.* An election made under this section may be made only if the aircraft or vessel is section 38 property, or property which would be section 38 property but for section 48(a)(5) (relating to property used by governmental units), at the time the election is made and for all taxable years to which the election applies. The aircraft or vessel must be property which qualifies for the investment credit under section 38 unless the property does not qualify because it is described in section 48(a)(5). If an aircraft is used predominantly outside the United States (determined under § 1.48-1(g)(1)), it must qualify under the provisions of section 48(a)(2)(B)(i) and § 1.48-1(g)(2)(i). If a vessel is used predominantly outside the United States, it must qualify under the provisions of section 48(a)(2)(B)(iii) and § 1.48-1(g)(2)(iii). The aircraft or vessel may not be suspension or termination period property described in section 48(h) or section 49(a) (as in effect before the enactment of the Revenue Act of 1978).

See paragraph (g) (3) and (4) of this section for rules which apply if the property ceases to be section 38 property.

(2) *United States manufacture or construction.* An election under this section may be made only if the aircraft or vessel is manufactured or constructed in the United States. The aircraft or vessel will be considered to be manufactured or constructed in the United States if 50 percent or more of the basis of the aircraft or vessel is attributable to value added within the United States.

(3) *Exclusion of certain property used outside the United States.* The term “aircraft or vessel” as used in this paragraph (b) does not include any property which is used predominantly outside the United States and which qualifies as section 38 property under—

(i) Section 48(a)(2)(B)(v), relating to containers used in the transportation of property to and from the United States,

(ii) Section 48(a)(2)(B)(vi), relating to certain property used for the purpose of exploring for, developing, removing, or transporting resources from the Outer Continental Shelf, or

(iii) Section 48(a)(2)(B)(x), relating to certain property used in international or territorial waters.

(c) *Leases or subleases to which the election applies.* At the time the election under this section is made and for all taxable years for which the election applies, the lessee of the aircraft or vessel must be a United States person. In addition, the aircraft or vessel may not be subleased to a person who is not a United States person unless the sublease is a short-term sublease. For purposes of this section, a short-term sublease is a sublease for a period of time (including any period for which the sublease may be renewed or extended) which is less than 30 percent of the asset guideline period of the aircraft or vessel leased (determined under section 167(m)). See paragraphs (g) (3) and (4) of this section for rules which apply if the requirements of this paragraph (c) are not met.

(d) *Income to which the election applies.* An election under this section applies to all amounts derived by the taxpayer with respect to the aircraft or vessel which is subject to the election. The

election applies to all amounts which are includible in the taxpayer's gross income whether or not includible during or after the period of a lease to which the election applies. Amounts derived by the taxpayer with respect to the aircraft or vessel include any gain from the sale, exchange, or other disposition of the aircraft or vessel. If by reason of the allowance of expenses and other deductions, there is a loss with respect to an aircraft or vessel, the election applies to treat the loss as having a source within the United States. Similarly, if the sale, exchange or other disposition of the aircraft or vessel which is subject to an election results in a loss, it is treated as having a source within the United States. See paragraph (e)(2) of this section for the application of an election under this section to the income of certain transferees or distributees.

(e) *Effect of election—(1) In general.* An election under this section applies to the taxable year for which it is made and to all subsequent taxable years for which amounts in respect of the aircraft or vessel to which the election relates are includible in gross income. However, the election may be revoked under paragraph (g) (1) or (2) of this section or terminated under paragraph (g)(3) of this section.

(2) *Certain transfers involving carryover of basis.* (i) If an electing taxpayer transfers or distributes an aircraft or vessel which is subject to the election under this section, the transferee or distributee will be treated as having made an election under this section with respect to the aircraft or vessel if the basis of the aircraft or vessel in the hands of the transferee or distributee is determined by reference to its basis in the hands of the transferor or distributor. This paragraph (e)(2)(i) applies even though the transferor or distributor recognizes an amount of gain which increases basis in the hands of the transferee or distributee and even though the transferee or distributee is a nonresident alien individual or foreign corporation. For example, if a corporation distributes a vessel which is subject to an election under this section to its parent corporation in a complete liquidation described in section 332(b), the parent corporation will be

required to treat all amounts includible in its gross income with respect to the vessel as income from source within the United States if, unless the election is revoked or terminated under paragraph (g) of this section, the basis of the property in the hands of the parent is determined under section 334(b)(1) (relating to the general rule on carryover of basis). In further illustration, if a corporation distributes a vessel (subject to an election) in a distribution to which section 301(a) applies, the distributee will be treated as having made the election with respect to the vessel if its basis is determined under section 301(d)(2) (relating to basis of corporate distributees) even though the basis is the fair market value of the vessel under section 301(d)(2)(A).

(ii) If a member of an affiliated group which files a consolidated return transfers an aircraft or vessel subject to an election to another member of that group, the transferee will be treated as having made the election with respect to the aircraft or vessel. In addition, if a partnership distributes an aircraft or vessel subject to an election to a partner, the partner will be treated as having made the election with respect to the aircraft or vessel.

(iii) If paragraph (e)(2) (i) and (ii) of this section do not apply, the election under this section with respect to an aircraft or vessel will not be considered as made by a transferee or distributee.

(f) *Election*—(1) *Time for making the election*. The election under this section must be made before the expiration of the period prescribed by section 6511(a) (or section 6511(c) if the period is extended by agreement) for making a claim for credit or refund of the tax imposed by chapter 1 for the first taxable year for which the election is to apply. The period for that first taxable year is determined without regard to the special periods prescribed by section 6511(d).

(2) *Manner of making the election*. An election under this section must be made by filing with the income tax return (or an amended return) for the first taxable year for which the election is to apply a statement, signed by the taxpayer, to the effect that the

election under section 861(e) is being made. The statement must—

(i) Set forth sufficient facts to identify the aircraft or vessel which is the subject of the election,

(ii) State that the aircraft or vessel was manufactured or constructed in the United States,

(iii) State that the aircraft or vessel is section 38 property described in § 1.861-9(b) which was leased to a United States person (as defined in section 7701(a)(30) of the Code) pursuant to a lease entered into after August 15, 1971,

(iv) State that the electing taxpayer is the owner of the aircraft or vessel,

(v) State the lessee of the aircraft or vessel is not a member of a controlled group of corporations (as defined in section 1563) of which the taxpayer is a member,

(vi) Give the name and taxpayer identification number of the lessee of the aircraft or vessel, and

(vii) State that the aircraft or vessel is not subject to a sublease (other than a short-term sublease) to any person who is not a United States person.

(3) *Election by partnership*. Any election under this section with respect to an aircraft or vessel owned by a partnership shall be made by the partnership. Any partnership election is applicable to each partner's partnership interest in the aircraft or vessel. However, an election made by a partner before August 8, 1979 will be recognized where the partnership made no election and the election can no longer be revoked without the consent of the Commissioner under paragraph (g)(1) of this section.

(g) *Termination of election*—(1) *Revocation without consent*. A taxpayer may revoke an election within the time prescribed in paragraph (f)(1) of this section without the consent of the Commissioner. In such a case, the taxpayer must file an amended income tax return for any taxable year to which the election applied.

(2) *Revocation with consent*. Except as provided in paragraph (g) (1) or (3) of this section, an election made under this section is binding unless consent to revoke is obtained from the Commissioner. A request to revoke the election must be made in writing and